## Why so many franchisees fail

It's often said that success has many fathers, but that failure is an orphan. After having practised franchise law for over 26 years, someone asked me a few weeks ago why so many franchisees fail.

There are a variety of reasons. The first is because the franchisee is undercapitalized. Having borrowed money from banks and family, the struggling franchisee finds that she's unable to withstand the vagaries of the marketplace and a downturn in the economy. There simply isn't enough money to keep the business going. Accordingly, if you're interested in acquiring a franchised business, don't go into it on shoestring budget. You won't be able to deal with the inevitable 'downs' that come with the potential 'ups' – if and when those 'ups' happen.

The second reason has to do with location. If the location for the franchised business is on the wrong side of the street (no left turns permitted!) or the wrong end of the mall, it will have disastrous consequences for the business. There are consultants that can help you with a location analysis to avoid these sorts of problems. Likewise, if the ideal location is on the nicest street or in the fanciest mall, but the rent for that location is stratospheric in relation to the cost of the products being sold, the business will flounder and die.

An accountant or business consultant can assist you with working out whether the business can withstand the rent charged for a particular location, and if it can't, go back to the drawing board to find another location or another franchise.

Franchisors may also give assistance on site selection. Indeed they may have had their own people do an exhaustive site analysis, concluding that 'location A' will be a real winner. The problem with that is, unless they're on the lease and subletting it you, they will rarely make a representation to you that the location is a winner ( in case it isn't). However, if their experience is limited to Minneapolis, Houston or Toronto, that experience may have no bearing on a location in Regina, Calgary, Vancouver or Victoria. So for a bricks-and-mortar retail business, site selection analysis is of fundamental importance.

There are obviously other reasons why franchised businesses fail. Perhaps the public doesn't accept the product or service, or maybe there's the marketplace is too competitive. Franchisees who have obtained a 'golden handshake' from a previous 9-to-5 job, and are looking to invest in their own business, may find they aren't prepared to put in the hours and sweat needed to make a franchise successful. It's a lot of work. Or the franchisor may be undercapitalized because it is just starting out itself, or frankly, it's

being run by people who don’t know what they’re doing.

Sometimes franchisors and their salespeople will do and say anything to sell a franchise, including making wildly inaccurate or even fraudulent misrepresentations about the prospective business to make the sale. Indeed, it’s arguable that misrepresentations in the sales process effectively led to the enactment of franchise legislation throughout the U.S. and in Canada, giving franchisees who may have been misrepresented, a statutory remedy to get their money back.

Alberta, Manitoba, Ontario, PEI and New Brunswick have such legislation in Canada. British Columbia, Saskatchewan, Québec, Nova Scotia and Newfoundland do not, although a recent report from the B.C. Law Institute recommends such legislation in the province.

So what can prospective franchisees do to avoid failing?

Certainly, franchisees should investigate the opportunity and perform their due diligence, even if it requires hiring accountants, business consultants or location consultants. Obviously lawyers should be consulted to review the franchise agreement and disclosure document and to be able to tell you what the franchisor can do under the contract if you don’t perform. Is the franchisor a member of the Canadian Franchise Association? If not, why not?

Part of your due diligence is to speak to as many existing or former franchisees of the system as possible to get a comfort level with the business and the franchisor. You need only ask three questions: Are you happy with your decision to acquire this franchise? Are you making any money? And would you do it again?

But if someone were to ask me what the leading cause of franchisee failure is, I’d say selling it to yourself. I find that franchisees are so enamoured by the possibility of becoming the next McDonald’s that they don’t do the necessary legwork. That is, they don’t speak to other franchisees or former franchisees (who may be suing the franchisor), they don’t get accounting or location advice, and they don’t get legal advice because they don’t believe they won’t succeed. They believe everything the franchisor has told them without being critical or analytical. They have invested emotionally as well as financially in the decision to become a franchisee. This is a critical mistake made by many a failed franchisee.

As Kenny Rogers sang: *Know when to fold ’em. Know when to walk away And know when to run.*

*Tony Wilson is a franchising, licensing and intellectual property lawyer at Boughton Law Corp. in Vancouver, he is an adjunct professor at Simon Fraser University (SFU), and he is the author of two books: Manage Your Online Reputation, and Buying a Franchise in Canada. His opinions do not reflect those of the Law Society of British Columbia, SFU or any other organization.*

*Follow us @GlobeSmallBiz and on Pinterest*
*Join our Small Business LinkedIn group*
*Add us to your circles*
*Sign up for our weekly newsletter*

Follow us on Twitter: @GlobeSmallBiz